

ALTERNATIVE FORECASTS

DRI has assigned a 60% probability of occurrence to its March 1999 baseline forecast of the U.S. economy. The major features of this forecast include:

- Real GDP growth is 3.7% in 1999, then slows to 2.1% in 2000, rises to 2.4% in 2001; and slides to 2.0% in 2002.
- U.S. nonfarm employment growth is 2.3% this year, then averages about 1.0% thereafter;
- the U.S. civilian unemployment rate rises gradually over the forecast period, but remains well below the full-employment level;
- consumer confidence peaks in 1999, then slowly tapers off over the forecast period;
- consumer inflation accelerates from 1998's 1.6%, but remains under 2.5% through 2002;
- the federal budget posts surpluses in each year of the forecast;
- and the U.S. merchandise trade deficit widens.

While the baseline scenario represents the most likely path for the national economy over the next few years, the uncertainties surrounding several key variables mean that other outcomes are also possible. To account for this, DRI prepares alternative forecasts based on different assumptions regarding these key variables. Two of these alternative forecasts, along with their impacts on the Idaho economy, are discussed below.

While it is believed the economy will not suffer a recession over the forecast period, it should be noted that the risk of a recession is high. A review of the probabilities of occurrence for each forecast scenario shows this. The baseline does not include a recession and its probability of occurrence is 60%. However, both of the alternative scenarios do contain recessions and each has a probability of occurrence of 20%. Thus, their combined probability of occurrence is 40%. This implies the chances of the economy suffering a recession are nearly even with the economy escaping a recession.

PESSIMISTIC SCENARIO

Interestingly, both alternate scenarios revolve around a sharp stock market correction. The major difference between these two alternatives stems from the timing of the correction. In the *Pessimistic Scenario* the correction happens sooner than later. This scenario has been assigned a 20% probability of occurrence with another round of Asian currency depreciation leading to a sharp drop in the U.S. stock market. Because of America's already low savings rate and high level of wealth, consumers are more sensitive to stock market declines than in the past. The decline in share prices quickly undermines consumer confidence and thus consumer spending. With the loss of this important growth engine, the economy suffers a recession in 2000. This downturn is exacerbated by the Y2K problem, as productivity disruptions caused by computer failures and imbedded microchips cause severe production losses.

Fortunately, Federal Reserve reaction to the recession should be swift. As was demonstrated by the interest rate cuts in the fall of 1998, Chairman Greenspan is not willing to let the current expansion die on his watch. Likewise, the Federal Reserve is expected to make a series of sharp reductions to

IDAHO ECONOMIC FORECAST
BASELINE AND ALTERNATIVE FORECASTS
APRIL 1999

	BASELINE				PESSIMISTIC				LATE RECESSION			
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
GDP (BILLIONS)												
Current \$	8,907	9,196	9,574	9,949	8,897	8,917	9,178	9,623	8,922	9,288	9,640	9,737
% Ch	4.7%	3.2%	4.1%	3.9%	4.5%	0.2%	2.9%	4.8%	4.8%	4.1%	3.8%	1.0%
1992 Chain-Weighted	7,828	7,989	8,178	8,342	7,820	7,769	7,930	8,214	7,828	8,006	8,117	8,049
% Ch	3.7%	2.1%	2.4%	2.0%	3.5%	-0.6%	2.1%	3.6%	3.7%	2.3%	1.4%	-0.8%
PERSONAL INCOME - CURR \$												
Idaho (Millions)	27,164	28,471	29,837	31,264	27,154	28,139	29,230	30,596	27,196	28,679	30,137	31,237
% Ch	5.0%	4.8%	4.8%	4.8%	5.0%	3.6%	3.9%	4.7%	5.1%	5.5%	5.1%	3.7%
U.S. (Billions)	7,476	7,782	8,099	8,411	7,473	7,643	7,822	8,135	7,484	7,845	8,189	8,337
% Ch	4.9%	4.1%	4.1%	3.9%	4.9%	2.3%	2.3%	4.0%	5.0%	4.8%	4.4%	1.8%
PERSONAL INCOME - 1992 \$												
Idaho (Millions)	23,816	24,584	25,267	25,938	23,815	24,418	25,022	25,777	23,800	24,545	25,146	25,560
% Ch	3.8%	3.2%	2.8%	2.7%	3.8%	2.5%	2.5%	3.0%	3.7%	3.1%	2.5%	1.6%
U.S. (Billions)	6,556	6,721	6,860	6,979	6,555	6,634	6,698	6,855	6,551	6,715	6,835	6,823
% Ch	3.7%	2.5%	2.1%	1.7%	3.7%	1.2%	1.0%	2.4%	3.6%	2.5%	1.8%	-0.2%
TOTAL NONFARM EMPLOYMENT												
Idaho (Thousands)	535.6	548.2	559.8	571.0	535.5	543.8	552.6	567.9	535.6	548.4	558.4	561.5
% Ch	2.7%	2.3%	2.1%	2.0%	2.6%	1.5%	1.6%	2.8%	2.6%	2.4%	1.8%	0.6%
U.S. (Millions)	128.8	130.2	131.6	132.5	128.7	128.3	128.1	130.1	128.8	130.5	131.4	129.1
% Ch	2.3%	1.1%	1.1%	0.7%	2.3%	-0.3%	-0.2%	1.6%	2.3%	1.3%	0.7%	-1.7%
GOODS PRODUCING SECTOR												
Idaho (Thousands)	112.9	114.2	116.2	117.6	112.8	111.1	112.8	117.1	113.0	114.8	115.8	112.8
% Ch	1.2%	1.2%	1.7%	1.2%	1.1%	-1.5%	1.5%	3.9%	1.2%	1.7%	0.8%	-2.6%
U.S. (Millions)	25.1	24.4	24.1	23.7	25.1	23.7	22.8	23.0	25.1	24.5	24.1	22.7
% Ch	-0.7%	-2.7%	-1.4%	-1.3%	-0.8%	-5.4%	-3.7%	1.0%	-0.7%	-2.4%	-1.7%	-5.8%
SERVICE PRODUCING SECTOR												
Idaho (Thousands)	422.7	434.0	443.6	453.4	422.7	432.7	439.8	450.7	422.6	433.5	442.6	448.7
% Ch	3.1%	2.7%	2.2%	2.2%	3.1%	2.4%	1.7%	2.5%	3.0%	2.6%	2.1%	1.4%
U.S. (Millions)	103.7	105.8	107.6	108.7	103.7	104.6	105.2	107.0	103.7	106.0	107.4	106.5
% Ch	3.1%	2.1%	1.6%	1.1%	3.1%	0.9%	0.6%	1.7%	3.1%	2.2%	1.3%	-0.8%
FINANCIAL MARKETS												
Federal Funds Rate	4.8%	5.0%	5.0%	5.0%	4.8%	4.5%	4.3%	4.2%	4.7%	4.9%	5.8%	4.9%
Bank Prime Rate	7.8%	8.0%	8.0%	8.0%	7.8%	7.5%	7.3%	7.2%	7.8%	7.9%	8.8%	7.9%
Mort Rate, New Homes	7.1%	7.3%	7.1%	6.9%	7.2%	7.3%	7.1%	7.0%	7.1%	7.1%	7.6%	7.8%
INFLATION												
GDP Price Deflator	1.0%	1.2%	1.7%	1.9%	1.0%	0.9%	0.8%	1.2%	1.1%	1.8%	2.4%	1.8%
Personal Cons Deflator	1.2%	1.5%	2.0%	2.1%	1.2%	1.1%	1.4%	1.6%	1.4%	2.3%	2.6%	2.0%
Consumer Price Index	1.8%	2.1%	2.3%	2.4%	1.8%	1.6%	1.6%	1.9%	2.0%	2.7%	3.0%	2.3%

Forecast Begins the FOURTH Quarter of 1998

short-term rates. This should get the economy back in growth mode in short order. The nation's central bank is able to take this action because inflation should still be low in 2000. Another reason the recession should be short lived is the improvement of Asian economies around that same time.

The U.S. recession serves a blow to the Idaho economy from which it is slow to recover. Idaho nonfarm employment, which is projected to grow at least 2.0% per year in the baseline case, drops to about 1.5% growth in 2000 and 2001. And despite a 2.8% growth spurt in 2002, nonfarm employment fails to make up lost ground. In 2002, Idaho nonfarm employment is 567,900, about 3,000 lower than in the baseline case. Idaho real personal income follows a similar path. Its growth rate dips to 2.5% in both 2000 and 2001, compared to about 3.0% in the baseline forecast. By 2002, it is \$160 million lower than in the baseline.

LATE-RECESSION SCENARIO

The *Late-Recession Scenario* has also been assigned a 20% probability of occurrence. In this scenario, the stock market correction comes later than in the *Pessimistic Scenario*, but with more dire consequences. Under this scenario, real GDP during 1999-2000 is stronger than in the baseline. This is because consumer spending continues to boom. Inflationary pressures build in the surging economy. Tighter labor markets push inflation higher. In addition, rebounding commodity prices, caused by strong demand both at home and abroad, add more fuel to inflation fires. The dollar slips against other currencies. Although the economy is ripe for an interest rate hike, the Federal Reserve delays tightening because of higher inflation.

With inflation running near 4.0% in late 2000, the Federal Reserve can no longer ignore it and is forced to raise short-term rates. The stock market keeps climbing through 2000, reflecting the stronger economic growth and low interest rates. When the correction does come, it damages consumer wealth and confidence. Demand is hurt further by rising interest rates that choke off business investment. The result is a recession that starts in 2001 and is more severe than the one forecast in the *Pessimistic Scenario*.

In this scenario, the Idaho economy is slightly stronger in the early years of the forecast, but weakens in the latter years. Specifically, nonfarm employment grows 2.4% in 2000 compared to the baseline's 2.3%. However, employment growth starts trailing off soon after, going from 1.8% in 2001 to 0.6% in 2002. Idaho real personal income growth slows steadily over the forecast period. It is 3.7% in 1999, 3.1% in 2000, 2.5% in 2001, and 1.6% in 2002.